Title 2. California Public Employees' Retirement System

NOTICE OF PROPOSED REGULATORY ACTION

NOTICE IS HEREBY GIVEN that the Board of Administration (Board) of the California Public Employees' Retirement System (CalPERS) proposes to take the regulatory action described below in the Informative Digest after considering public comments, objections, or recommendations.

I. PROPOSED REGULATORY ACTION

In this filing, the Board proposes to amend Article 7.6 entitled "Participation in Risk Pools" in Title 2 of the California Code of Regulations. Sections 588.1 and 588.2 would be amended. This proposed regulatory action pertains to the participation of contracting agencies, including county offices of education, school districts and community college districts, in risk pools for retirement purposes.

II. WRITTEN COMMENT PERIOD

Any interested person may submit written comments relevant to the proposed regulatory action. The written comment period closes at 5:00 p.m. on February 16, 2009. The Regulations Coordinator must receive all written comments by the close of the comment period. Comments may be submitted via facsimile at (916) 795-4607; e-mail at joe_parilo@calpers.ca.gov; or mailed to the following address:

Joe Parilo, Acting Regulations Coordinator
California Public Employees' Retirement System
P.O. Box 942702
Sacramento, California 94229-2702
Telephone: (916) 795-3484

III. PUBLIC HEARING

Comments on the proposed actions will also be taken at a public hearing to be placed on the agenda of the regularly scheduled meeting of the Benefits and Program Administration Committee of the CalPERS Board:

March 17, 2009
9:00 a.m.
California Public Employees' Retirement System
Lincoln Plaza North, Auditorium
400 Q Street
Sacramento, California 95811

IV. ACCESS TO HEARING ROOM

The hearing room will be accessible to persons with mobility impairments, and it can be made accessible to persons with hearing or vision impairments upon advance request to the Regulations Coordinator.

V. AUTHORITY AND REFERENCE

The CalPERS Board has general authority to take regulatory action under Government Code section 20121. The Board has specific authority to amend sections 588.1 and 588.2 under Government Code section 20840. This action would implement, interpret and make specific Government Code section 20840.

VI. INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Changes to section 588.1 are being proposed to clarify the effective date for employee benefits mandated by risk pooling for both new and existing contracting agencies entering a risk pool.

Changes to section 588.2 are being proposed to modify the criteria under which contracting agencies with less than 100 employees may participate in a risk pool. The proposed amendment to section 588.2 would authorize staff to place a new contracting agency in an individual non-pooled plan rather than in a risk pool if CalPERS actuarial staff deem it necessary to protect pooled employers from potential unfavorable additional costs attributable to new contracting agencies.

VII. EFFECT ON SMALL BUSINESS

The proposed regulatory action does not affect small business because it applies only to public agency participation in risk pools.

VIII. DISCLOSURES REGARDING THE PROPOSED REGULATORY ACTION

A. MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS: The proposed regulatory action does not impose a mandate on local agencies or school districts.

B. COST OR SAVINGS TO ANY STATE AGENCY: The proposed regulatory action does not impact costs or savings for any state agency.

C. COST TO ANY LOCAL AGENCY OR SCHOOL DISTRICT: The proposed regulatory action does not impact costs or savings for any local agency or school district, such that costs would qualify for reimbursement under Government Code section 17500 et seq.

D. NONDISCRETIONARY COSTS OR SAVINGS IMPOSED ON LOCAL AGENCIES: The proposed regulatory action does not impose non-discretionary costs or savings on local agencies.

E. COSTS OR SAVINGS IN FEDERAL FUNDING TO THE STATE: The proposed regulatory action does not impact any federal funding to the state.

F. ADVERSE ECONOMIC IMPACT: CalPERS has made an initial determination that the proposed regulatory actions will not have a significant statewide adverse economic impact directly affecting businesses including the ability of business in California to compete with business in other states.

G. COST IMPACT ON REPRESENTATIVE PRIVATE PERSONS OR BUSINESSES: CalPERS is not aware of any cost impacts that a representative private person, or business would necessarily incur in reasonable compliance with the proposed action.

H. IMPACT ON JOBS AND BUSINESSES WITHIN CALIFORNIA: The proposed regulatory action will not: (1) create or eliminate jobs within California; (2) create new businesses or eliminate existing businesses within California; or (3) affect the expansion of businesses currently doing business within California.

I. EFFECT ON HOUSING COSTS: The proposed regulatory action has no significant effect on housing costs.

IX. CONSIDERATION OF ALTERNATIVES

The Board must determine that no reasonable alternative considered by the Board or that has otherwise been identified and brought to the attention of the Board would be more effective in carrying out the purpose for which the action is proposed or would be as effective as and less burdensome to affected private persons than the proposed action.

NOTICE OF PROPOSED REGULATORY ACTION

The Board invites interested persons to present statements or arguments with respect to alternatives to the proposed regulation at the above mentioned hearing or during the written comment period.

X. CONTACT PERSONS

Please direct inquiries concerning the substance of the proposed regulatory action to:

Jean Fannjiang
Actuarial Office
California Public Employees' Retirement System
400 Q Street
P.O. Box 942701
Sacramento, California 94229-2701

Telephone: (916) 795-2475
Fax: (9l6) 795-2744
E-mail: Jean_Fannjiang@calpers.ca.gov

Please direct requests concerning processing of this regulatory action to Joe Parilo, Acting Regulations Coordinator, at the address shown in Section II, or (916) 795-3484 (joe_parilo@calpers.ca.gov).

XI. AVAILABILITY OF STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATIONS

The entire rulemaking file is available for public inspection through the Acting Regulations Coordinator at the address shown above. To date the file consists of this notice, the proposed text of the regulation, and the Initial Statement of Reasons (ISOR). A copy of the proposed text and the ISOR is available at no charge upon telephone or written request to the Acting Regulations Coordinator.

The Final Statement of Reasons can be obtained, once it has been prepared, by written request to Joe Parilo, Acting Regulations Coordinator, at the address shown in Section II.

For immediate access, the regulatory material regarding this action can be accessed at CalPERS' web site at www.calpers.ca.gov under *About CalPERS > Legislation, Regulations & Statutes > Regulatory Actions > Current Regulatory Actions.*

XII. AVAILABILITY OF MODIFICATIONS TO PROPOSED AMENDMENT

The Board may, on its own motion or at the recommendation of any interested person, modify the proposed text of the amendment on regulations after the public comment period has closed. It may amend sections 588.1 and 588.2 as modified if the changes are sufficiently related to the original text so the public could have anticipated them.

If the Board modifies its regulatory action in this manner, it will prepare a comparison of the original proposed text and the modifications for an additional public comment period of not less than 15 days prior to the date on which the Board adopts, amends or repeals the resulting regulation. A copy of the comparison text will be mailed to all persons who submitted written comments or asked to be kept informed as to the outcome of this regulatory action.

Title 2. California Public Employees' Retirement System

NOTICE OF PROPOSED REGULATORY ACTION

PROPOSED AMENDMENTS TO

ARTICLE 7.6 OF CHAPTER 2 OF DIVISION 1 OF TITLE 2 OF THE CALIFORNIA CODE OF REGULATIONS

§ 588.1 Risk Pools – Required Participation for Existing Contracting Agencies; *Effective Date for Mandated Benefits for New and Existing Contracting Agencies*

Following the creation of risk pools pursuant to Section 20840 of the Government Code, any existing contracting agency with a rate plan of less than 100 active members on any annual actuarial valuation date shall be required to participate in a risk pool. Participation shall be effective as of that valuation date for all members of that rate plan, but no earlier than the June 30, 2003 actuarial valuation which will be used to set employer contribution rates for fiscal year 2005-2006. *The effective date of a pool's mandated benefits pursuant to §20840 of the Government Code for contracting agencies who participate in a risk pool is the first day that the agency is required to pay for the mandated benefits.*

NOTE: Authority cited: Sections 20120, 20121 and 20840, Government Code. Reference: Section 20840, Government Code.

§ 588.2 Risk Pools – Required Participation for New Contracting Agencies

A new contracting agency with CalPERS following the creation of risk pools shall be required to participate in a risk pool if the number of active members in the rate plan is less than 100 at the time of the initial actuarial valuation *provided that the actuary determines such participation will not be unfavorable to other agencies in the pool. In the event that such participation would be unfavorable, the matter may be referred to the CalPERS Board for a hearing.*

NOTE: Authority cited: Sections 20120, 20121 and 20840, Government Code. Reference: Section 20840, Government Code.

INITIAL STATEMENT OF REASONS

Proposed Amendments to Sections 588.1 and 588.2 for Risk Pooling Regulations

Description of Public Problem, Administrative Requirement, or Other Condition or Circumstance that the Regulation is Intended to Address: Since 2003, the Board has had authority to create, combine or eliminate risk pools for local miscellaneous and local safety members. The Board may establish by regulations, the criteria under which contracting agencies, including school employers that choose to contract as public agency employers, may participate in risk pools.

Beginning with the June 30, 2003 actuarial valuations, plans with less than 100 active members have been mandated into risk pools based on their benefit formula and membership category. There are currently 10 public agency risk pools.

Currently, Government Code Section 20840(e) requires that each risk pool must contain the following benefits:

- Pre-retirement Optional Settlement 2 Death Benefit (Section 21548)
- Credit for Unused Sick Leave (Section 20965)
- Public Service Credit for Periods of Layoff (Section 21022)
- Public Service for Peace Corps or AmeriCorps: VISTA Service (Section 21023.5)
- Military Service Credit as Public Service (21024)
- Public Service Credit for Service Rendered to a Nonprofit Corporation (Section 21026)
- Military Service Credit for Retired Persons (Section 21027)
- Local System Service Credit Included in Basic Death Benefit (Section 21536)
- Cancellation of Payments for Service Credit Purchase Upon Industrial Disability Retirement (Section 21037) (Mandated for all contracting agencies effective 1/1/2004)

Current regulations require any existing contracting agency with a rate plan of less than 100 active members on any annual actuarial valuation date to participate in a risk pool. For such rate plan, the sharing of risk resulting from participating in a risk pool begins on the day after the date of the actuarial valuation. For an employer required to participate in a risk pool based on the June 30, 2007 actuarial valuation, risk is being shared beginning on July 1, 2007. However, the date a rate plan starts participating in a risk pool and shares risk with other rate plans of the same pool is different from the effective date of the pool's mandated benefits (except where the contracting agency employer already includes the mandated benefit for its employees in its existing CalPERS contract.)

Because of the complexity and the amount of time needed to obtain the information for each individual participant that is required to perform an actuarial valuation, there currently is a two year lag for public agencies between the valuation date of an actuarial valuation and the effective date of the new employer contribution rates established by that valuation. For example, the June 30, 2007 actuarial valuations that were recently completed by the actuarial staff were used to establish the employer contribution rates for fiscal year 2009-2010.

The proposed amendment to regulation 588.1 would codify the existing practices and clarify that even though an employer (whether a new contracting agency or an existing contracting agency) begins sharing the demographic risk with other plans of the same risk pool as of the date that participation is mandated, the mandated employee benefits not already offered by the employer to its employees will become available to employees only when the employer's contributions to the risk pool reflect the increased costs of the benefits. Thus, in accordance with current time frames, employees of an employer that are required to join a risk pool on June 30, 2007 would not be covered by the risk pool's added mandated benefits nor would the employer begin to contribute toward the risk pool's added mandated benefits until July 1, 2009.

In addition, current regulations require participation in a risk pool by new contracting agencies if the agency has less than 100 active members at the time of the initial actuarial valuation. This absolute requirement to participate in a risk pool may prove detrimental to existing contracting agencies in a pool if the new contracting agency's retirement benefit costs are significantly higher than those of the pooled agencies. If the new agency's costs are higher than costs of employers in the pool, the employers in the pool will be harmed because they will be paying increased contributions covering amounts for which the new contracting agency was previously responsible.

<u>Specific Purpose</u>: The proposed amendments to sections 588.1 and 588.2 are intended to meet the requirements of Government Code Section 20840. The proposed changes in section 588.1 clarify the effective date of the pool's mandated benefits for contracting agencies participating in risk pools. The proposed changes in section 588.2 give CalPERS the authority to place a new contracting agency in an individual non-pooled plan rather than in a risk pool if CalPERS actuarial staff deems it necessary to protect pooled employers from potential unfavorable additional costs attributable to new contracting agencies.

<u>Necessity</u>: The proposed amendment to regulation 588.1 would codify the existing practices and clarify that even though an employer begins sharing the demographic risk with other plans of the same risk pool as of the date that participation is mandated, the added mandated employee benefits will become available to employees only when the employer's contributions to the risk pool reflect the increased costs of the benefits.

This is not a change from existing practices. The approach has been used since the implementation of pooling. Attempting to make mandated benefits effective as of the date of the actuarial valuation is impractical because twelve months or more elapse between the valuation date and completion of the actuarial valuations when CalPERS first becomes aware that the active member count has fallen below 100 active members (i.e. the actuarial valuations as of June 30, 2007 were completed in October 2008). Making the effective date of the mandated benefits the date of the actuarial valuation would require the pool's mandated benefits to be administered retrospectively causing great administrative difficulty. Meanwhile, the contracting agency is not required to start making contributions for the mandated benefits until the start of the following fiscal year.

For ease of administration of risk pools and fairness among all employers of the same risk pools, changes to section 588.1 are needed to codify current practices and to clarify the Mandated Benefit Effective Date for plans participating in the risk pools as the first day that the contracting agency is required to pay for the mandated benefits.

The proposed amendment to regulation § 588.2 is needed to provide an exception to the requirement that new contracting agencies with less than 100 active members would be mandated to join a risk pool for the reasons set forth below.

Recently, the Actuarial Office has performed new contracting agency actuarial valuations for employers currently participating in a 1937 Act County Retirement System. As a result of different actuarial assumptions applied by CalPERS, some of these valuations have revealed that the new contracting agency's employer contribution rates were significantly higher under the County Plan than they would be under CalPERS. These dramatically different employer contribution rates given by CalPERS and other retirement systems result from application of different actuarial assumptions to actuarial valuations.

Generally speaking, it takes several years to identify a plan’s true experience on salary growth and various decrement rates. For example, a new group may have a very different salary scale compared with CalPERS plans. Therefore, for the purpose of protecting pooled employers from additional costs attributable to new contracting agencies, avoiding potential dispute by new contracting agencies, preserving the actuarial soundness of risk pools and easing the administration of risk pools, changes to § 588.2 are needed to allow CalPERS actuarial staff to deny participation in a risk pool if the actuary finds that participation would be unfavorable to the pool and its participants. Upon a finding that participation would be unfavorable, the matter may be referred to the CalPERS Board for a hearing for determination.

The proposed amendment adds the same language that already is included in Regulation § 588.3 relating to optional participation by contracting agencies with 100 or more employees.

<u>Technical, Theoretical and/or Empirical Studies, Reports or Documents</u>:
Not applicable.

<u>Alternatives to the Regulatory Action and CalPERS’ Reasons for Rejecting Those Alternatives</u>: CalPERS has considered alternatives to this proposal, and has determined that there is no more effective way to carry out its purpose that would be less burdensome.

<u>Alternatives to the Regulatory Action that Would Lessen any Adverse Impact on Small Businesses</u>: The proposed action has no cost impact on small businesses because it applies only to public agency employee retirement benefits.